DIRECTORATE OF INTELLIGENCE
7 March 1988

PANAMA: COPING WITH THE FINANCIAL CRISIS

Summary

In our judgment, the next few weeks will be the most critical for Panama City as it attempts to restore order in the banking system and meet its essential expenditures. If the regime weathers the immediate crisis, its chances of developing additional sources of revenue and coping with the political tensions that would accompany harsh austerity measures would be significantly improved. If, on the other hand, Panama´s dollar-based domestic banking system collapsed, most alternative sources of financing probably would dry up, creating an acute financial crisis. Under such circumstances, we believe Noriega would not hesitate to implement radical economic measures such as nationalizing the banking system, ending the use of the US dollar as Panama´s national currency, or even freezing US assets in Panama to avoid relinquishing power. [redacted] 25X1

We estimate that the government will require about $158 million to meet essential expenditures in March and April. If business activity quickly returns to near-normal levels, government reserves and expected receipts should be adequate to cover essential bills. On the other hand, if most banks remain closed and business activity remains restricted, government income could be reduced by half--generating a cash shortfall of as much as $40 million over the next two months. [redacted] 25X1

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Over the next year, we estimate that the government will need from $1.67 to $1.85 billion to meet its financial requirements and that government revenues will total no more than $1.1 billion. If, as we expect, Panama does not make its $550 million in scheduled debt payments this year, the shortfall would be reduced to a level approximately equal to that of last year. 25X1

Several options would be available to Noriega to address both an immediate budgetary crisis and the regime´s longer term financing requirements. Hundreds of millions of dollars could be obtained by imposing harsh austerity measures, tapping the personal accounts of Noriega and other wealthy senior military officers, or cutting deals with Latin American drug traffickers. In addition, the regime might acquire lesser sums from foreign governments or private investors. 25X1

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The Short-Term Budget Problem

Financial Requirements

We calculate that the regime will need $158 million to meet essential government expenditures in March and April (See Table 1: Panama: Short-Term Financing Requirements). The most important requirement is for some $82 million to meet government civilian and military payrolls. The regime's financial crunch will be slightly more severe in April because payroll expenditures will include an additional $12 million to cover triannual worker bonuses, that equal one third of a month's salary. 25X1

The regime also owes foreign commercial creditors $115 million in interest and principal payments in March and April, but we agree with the assessment of foreign bankers that Panama will <u>not</u> make those payments. Commercial bankers, however, expect Panama to negotiate a formal debt rollover in the near future. Bankers want assurances that interest payments--including $45 million that comes due in March--will be made as soon as possible. Panama's Bank Advisory Committee is scheduled to meet this week in New York to consider the regime's request for further postponements of $70 million in debt principal that comes due in April. 25X1

Financial Resources

We estimate that the regime will have $196 million to $206 million available--including liquid financial reserves at the National Bank of Panama and anticipated government revenues in March and April--to cover its essential expenditures:

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-- [redacted] The US restraining order temporarily freezing Panamanian assets held in the United States has further complicated the National Bank's liquidity problems. 25X1

-- Assuming that business activity returns to near-normal levels, we believe the regime's tax receipts will total $114 million in March and April.

-- Revenues from non-tax receipts--including net balances from public sector enterprises and canal and oil pipeline fees--have recently averaged about $28 million per month. The decision to escrow canal payments should cost the regime about $7 million a month. A similar decision on the pipeline would reduce regime receipts by a like amount. If only canal receipts are affected, regime non-tax receipts are likely to total $42 million during March and April. [redacted] 25X1

If the current banking crisis continues, however, collection problems and depressed economic activity could halve current regime income. This would reduce total funds available to the regime during March and April to $118-128 million--$30-40 million less than it needs to cover essential government expenditures. [redacted] 25X1

Long-Term Budget Problem

Based on US Embassy reporting and our analysis of public sector operations, we project the regime's total financial requirements for 1988 to fall between $1.67 billion and $1.85 billion. (See Table 2: Panama: Central Government Operations, 1985-1988) Government revenues during 1988 probably will range between $0.9 billion and $1.1 billion, assuming the banking system recovers in the next few weeks and the opposition refrains from sustained strike activities. We fully expect Panama to maintain the principal moratorium on Paris Club and commercial bank debt; thereby foregoing some $550 million in expenditures. The government, however, is likely to continue paying the higher priority debt service on short-term suppliers' credits and other trade financing. We believe the regime also will try to remain current on interest obligations, which will require nearly $100 million more than last year, according to Embassy and World Bank figures. [redacted] 25X1

Assuming the regime maintains its debt moratorium, it still must cope with an uncovered public sector deficit of $250 million--about $25 million higher than the 1987 gap. Covering

[redacted] 25X1

the financial deficit, however, will be more difficult in 1988 because of the large erosion in the Bank of Panama's financial reserves. Last year, the regime drew down its reserves by $190 million to cover its deficit. [redacted] 25X1

Alternative Sources of Financing

In addition to the postponement of debt payments, the regime could turn to internal borrowing, spending cuts, and other less traditional strategies and resources to narrow its financial gap. [redacted] 25X1 a number of options are available that would help the regime address both its most immediate economic crisis as well as its broader financing requirements in the coming months. [redacted] 25X1

Government Austerity Efforts

If the economic situation does not improve soon, we believe the regime would consider imposing strong austerity measures. Although Noriega would like to avoid the adverse political impact of such actions, he may calculate that the economic gains would outweigh the political costs. The regime might conclude that it is less risky to attempt drastic, but carefully managed, spending cuts rather than lurch toward potential insolvency that would spark serious domestic turmoil. [redacted] 25X1

One austerity package prepared by Delvalle's cabinet last month probably would net the government some $200 million if implemented this year. The plan, drafted in part to revive 1988 budget legislation that has been stalled since last December, includes a variety of measures to cut the public payroll, increase taxes and fees, and sell government-owned properties. Most notably, the measures propose not filling 5,800 vacant government jobs and consolidating various agencies to eliminate another 9,000 to 12,000 public sector positions. The plan also calls for increasing business, income, and consumption taxes sharply. The sale of property--primarily land in the reverted areas of the Canal Zone--or an unknown amount of other assets such as gold reserves could net the regime millions of dollars in income. [redacted] 25X1

Aid from Foreign Governments

[redacted] the regime has 25X1 intensified its efforts to secure funding from foreign governments. Although Panama City's requests to Japan and West European governments have gone unheeded, the regime might obtain aid--although the sum probably would not exceed $50 million--from one or more non-Western sources:

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-- The regime has been slowly expanding low-level commercial relations with the Soviet Union since last year and may be willing to strengthen economic and political ties if Moscow agrees to provide some financial support in the near term.

-- We believe the regime also might persuade other Latin governments to provide bridge loans or make deposits in Panamanian banks, particularly if the regime succeeds in portraying itself as a victim of US aggression. 25X1

In our judgment, however, little assistance is likely to be offered in the midst of Panama's immediate political and economic crisis. Foreign governments are unlikely to commit funds until they believe the regime's political position is secure and economic activity is returning to normal. In addition, many Latin governments probably would feel constrained from providing significant help because of their own economic difficulties. 25X1

Drug Money Laundering Proceeds

Latin American drug traffickers, in our view, control sufficient liquid assets to alleviate--or even end--the regime's current cash flow problem, if they so desired.* 25X1

Nonetheless, Panama's attractiveness as a place to launder drug money has been due principally to the banking center's convenience, stability, and a lack of international scrutiny--factors which no longer apply. Moreover, although the exact

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* In our judgment, the economic power of top narcotics traffickers was best illustrated in mid-1984 when, during meetings with Colombia's Attorney General and a former Colombian president, they offered to give Bogota $3 billion to retire its foreign debt in exchange for a guarantee not to extradite them to the United States, according to US Embassy reporting. 25X1

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dimensions of Noriega's personal relationship with narcotics traffickers remains unclear, we doubt that traffickers regard him, or even Panama, as essential to their activities. [redacted] 25X1

Assistance from Private, Non-Commercial Investors

[redacted] the regime--[redacted] 25X1 25X1 [redacted]-has actively sought financing from private, non-commercial sources. [redacted] 25X1 in late February, a source of the US Embassy reported on a regime plan to secure financial assistance from private individuals in Western Europe. Although the ability of private individuals or syndicates to provide a sufficient rescue package probably is limited, some adventurous private investors might be willing to lend Noriega $10-15 million at usurious terms even in the midst of the current crisis. While Panama City is reportedly studying the possibility of selling bonds, we believe that such a bond placement would be ill-conceived in the current circumstances. [redacted] 25X1

Resort to Radical Actions

If financial pressures on Panama mount, we believe the regime would consider radical measures to maintain its control. Panama City might move to nationalize the banking system or freeze assets of banks and other corporations in Panama. The regime probably realizes, however, that the large deposits once kept in Panama probably have been physically or electronically transferred out of the country, limiting the actual financial gain from such a move. According to Embassy estimates, US fixed investments in Panama total some $1.5 billion. Of this amount, $750 million is invested in oil refining and pipeline operations, $300 million in agricultural and fishing, and another $200 million in the banking sector. [redacted] 25X1

[redacted] 25X1 government officials also have discussed ending Panama's use of the US dollar as its currency as a measure of last resort. Such a move might alleviate the immediate financial crisis, but would create chaos in the domestic economy in the short- to medium-term. [redacted] 25X1

Other Intangibles

Several other factors could play a major role in the regime's ability to survive financially. The Defense Forces, for example, might choose to use some or all of the non-budgetary income it derives from extensive business and other enterprises to reduce the budget deficit, if it is not doing so already. Similarly, Noriega and other wealthy senior military officers might choose to plug critical government funding gaps by drawing on some of their financial holdings that are rumored to total in the hundreds of millions of dollars. Although we have no basis

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upon which to estimate the amount of personal funds that Noriega might expend, his determination to resist US pressure might make even large personal financial sacrifices worthwhile. [redacted] 25X1

Outlook

In our judgment, the next few weeks will be the most critical for Panama City as it attempts to restore order in the banking system and meet its essential expenses. Noriega's most pressing problem is to end the immediate banking and commercial crisis that has developed as a result of panic-driven capital flight and the currency shortages caused by the legal action filed by deposed President Delvalle. If he resolves the immediate financial crisis, his chances of developing additional sources of revenue and coping with the political tensions that would accompany harsh austerity measures would be significantly improved. [redacted] 25X1

On the other hand, if continuing financial crisis sparks panic withdrawals or keeps many banks from opening, business and commercial activities would be severely restricted and government revenues could fall by as much as half. The regime probably would react to such a drop in revenues by sharply reducing public works programs, delaying disbursements for government purchases, and postponing payments for critical imports such as oil. An indefinite currency shortage would almost certainly prompt widespread popular discontent forcing the regime to take even harsher measures. [redacted] 25X1

Without a shortrun turnaround in the banking situation, it is unlikely that the government will be able to weather the immediate crisis without crippling Panama's economy. The events of the last two weeks largely have torpedoed any remaining chance that Panama can survive as a major international financial center. In our judgment, most of the potential alternative sources of financing that might benefit the regime--such as deposits from drug money launderers or loans from private non-official lenders--would probably dry up. [redacted] 25X1

We believe Noriega would not hesitate to endorse radical economic measures before relinquishing power if he viewed his regime's financial situation as insolvable. [redacted] 25X1 Apart from policy moves such as the establishment of a new currency, Noriega eventually might choose to seize the physical assets of extensive US business interests in Panama or nationalize US companies, both to improve the regime's balance sheet and to retaliate against real or perceived official US actions. [redacted] 25X1

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TABLE 1: PANAMA: SHORT-TERM FINANCING REQUIREMENTS[1]
(Million US $)

MARCH

Expenditures		Resources	
Wages & salaries	35	Cash on hand	49-50
Goods & services	10		
Pensions & transfers	12	Income	75
Public works, etc.	8	Taxes	54[2]
Priority amortization	8	Non-tax receipts	21[3]
Total, excluding debt service	73	**Total availability**	115-125
Commercial bank interest	45[4]		
Total including debt service	118		

APRIL

Expenditures		Resources	
Wages & salaries	47	Income	81
Goods & services	10	Taxes	60
Pensions & transfers	12	Non-tax receipts	21
Public works, etc.	8		
Priority amortization	8		
Total, excluding debt service	85		
Commercial bank principal	70[4]		
Total including debt service	155		

TWO-MONTH TOTALS

Essentials expenditures	158	Current income	156
With all debt service	273	Income plus reserves	196-206

[1] Projected, assuming the economic situation soon normalizes following the general strike.
[2] Assumes 10 percent reduction in tax receipts this month because of general strike disturbances.
[3] Assumes Panama Canal Commission withholds its $7 million monthly fee remittance to the regime.
[4] These debt services are unlikely; Bank Advisory Committee does not expect Panama to meet March interest obligations. The Committee will convene in early March to consider regime's request to continue rolling over amortization as they have since existing rescheduling agreement signed 31 October 1985.

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TABLE 2: PANAMA: CENTRAL GOVERNMENT OPERATIONS, 1985-1988
(Million US $)

	1985	1986	1987[1]	1988[2]	1988[3]	1988[4]
Financing Requirements	**1,373**	**1,438**	**1,765**	**1,850**	**1,670**	**1,670**
Current Expenditures	956	993	1,055	1,100	980	980
Wages & Salaries	422	430	450	440	400	400
Goods & Services	110	105	145	120	100	100
Pensions & Transfer	121	137	140	141	110	110
Interest	303	321	320	399	370	370
Capital Expenditures	417	445	710	750	690	690
Public works, etc.	117	105	110	100	40	40
Amortization due	300	380	600	650	650	650
Current Revenues	**984**	**1,034**	**1,020**	**1,050**	**1,100**	**900**
Tax	689	754	730	720	760	700
Other	295	280	290	330	340	200
Financial Deficit	**389**	**444**	**745**	**800**	**570**	**770**
Debt Relief	**190**	**240**	**520**	**550**	**550**	**550**
Refinancing	190	240	--	--	550	550
Arrears	--	--	520	550	--	--
Gap After Debt Relief	**199**	**204**	**225**	**250**	**20**	**220**
External Financing	105	142	35	15	20	--
Commercial	30	10	10	--	--	--
Official	75	132	25	15	20	--
Internal Financing	94	62	190	235	--	220
Memorandum Items:						
Scheduled Debt Service	603	701	920	1,049	1,020	1,020
Paid	413	461	400	499	470	470

[1] Estimated.
[2] Projected, assuming current budget proposals, end of general strike, and no additional international financial sanctions.
[3] Projected, based on additional austerity measures.
[4] Projected, assuming fuller international sanctions and tough Panamanian austerity measures.

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SUBJECT: PANAMA: COPING WITH THE FINANCIAL CRISIS, 7 Mar 88

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1 - The Honorable John C. Whitehead, Deputy Secretary of State
2 - The Honorable Donald Gregg, Assistant to the President for National Security Affairs, Rm. 298, OEOB
3 - The Honorable John D. Negroponte, Deputy Assistant to the President for National Security Affairs, The White House
4 - Mr. Stephen I. Danzansky, Special Assistant to the President for International Economic Affairs, NSC, Rm. 365, OEOB
5 - Ambassador Jose Sorzano, NSC, Room 391, OEOB
6 - Mr. Kim Flowers, NSC, Room 391, OEOB
7 - The Honorable Michael H. Armacost, Under Secretary of State for Political Affairs
8 - The Honorable Elliott Abrams, Assistant Secretary of State for Inter-American Affairs, Room 6263, State
9 - The Honorable William G. Walker, Deputy Assistant Secretary of State for Central America, Room 4915, State
10- Mr. Richard Wyrough, Director of Panamanian Affairs, Room 4915, State
11- Mr. Vince Mayer, Panama Desk Officer, Rm. 4915, State
12- Mr. Luigi Einaudi, Director, Office of Policy Planning and Coordination/ARA Room 6913A, State
13- Amb. Morton I. Abramowitz, Asst. Secretary of State for Intelligence and Research, Room 6531, State
14- Mr. Robert Fouche, Director, Office of Analysis for Inter-American Republics/INR, Room 7358, State
15- Mr. James Buchanan, Chief South America Division/INR/IAA/SA, Room 7534, State
16- Mr. Charles Siegman, Federal Reserve Board, Rm. B1228
17- The Honorable Richard Armitage, Assistant Secretary of Defense for International Security Affairs, DOD, Room 4E808, Pentagon
18- Mr. Robert Pastorino, Deputy Assistant Secretary for Inter-American Affairs, DOD, Room 4C800, Pentagon
19- B. General Charles D. Link, JCS/JS, Pentagon, Room 2E980
20- LTG Dale A. Vesser, JCS, Room 2E996, Pentagon
21- RADM Anthony A. Less, JCS, Room 2E976, Pentagon
22- LTG Leonard H. Perroots, USAF, D/DIA, Room 3E258, Pentagon
23- Col. John Cash, DIO/DIA, Room 2A520, Pentagon
24- SOUTHCOM, J2
25- SOUTHCOM, J5
26- LTG William E. Odom, USA, D/NSA, Room 3A156, Fort Meade
27- Mr. Randall Fort, Department of the Treasury, Rm. 4324
28- Mr. David Mulford, Assistant Secretary of Treasury for International Affairs, Room 3432, Treasury
29- DDCI

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30-31 - DCI/DDCI Executive Staff, Room 7E12 (2)
32- DDI, Room 7E44
33- O/DDI, [redacted] Room 7E44 25X1
34- NIO/LA, Room 7E62
35- NIO/Economics, Rm. 7E62
36- NIC/AG, Room 7E47
[redacted] 25X1
38- C/LA/DO, Rm. 3C2016
39- C/LA/DO [redacted] Rm. 3C3203 25X1
40- C/LA [redacted] Rm. 3D30
41- C/LA [redacted] Room 3D30
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